



This Checklist is *not* a complete description of all plan requirements, and should *not* be used as a substitute for a complete plan review.

For Business Owner's Use

(DO NOT SEND THIS WORKSHEET TO THE IRS)

Every year it is important that you review the requirements for operating your Simplified Employee Pension (SEP). This Checklist is a "quick tool" to help you keep your plan in compliance with many of the important tax rules. Underlined text below will link you to Internet information.

1. Are all eligible employees participating in the SEP? Yes No

Any employee who is at least 21 years of age, was employed by you for 3 of the immediately preceding 5 years, and received compensation from you of at least \$450 during the year (subject to cost-of-living adjustments after 2004) is eligible to participate in a SEP.

2. Is the business that the SEP covers the only business that you and/or your family members own? Yes No

Employees of other businesses you and/or your family members own may have to be treated as employees when determining who is an eligible employee under this SEP.

3. Have you given all of your eligible employees information about the SEP? Yes No

You must give your employees certain information about the SEP, including a copy of the SEP document. Form 5305-SEP is your SEP document if you use the model form.

4. Are you determining each eligible employee's compensation using an appropriate definition in accordance with your SEP document? Yes No

Compensation used to determine contributions is limited to \$200,000 for 2003, 205,000 for 2004, and is subject to cost-of-living adjustments in later years.

5. Are contributions made only to a traditional IRA? Yes No

All SEP contributions must go to traditional IRAs set up for the eligible employees.

6. Are SEP contributions to each employee's IRA limited as required by law? Yes No

Contributions to a SEP-IRA are limited to the lesser of 25% of the employee's compensation for the year or \$40,000 for 2003 (\$41,000 for 2004, and subject to cost-of-living adjustments for later years).

7. Are employer contributions immediately 100% vested? Yes No

Employer contributions cannot be conditioned on anything. Once made, the employee owns all contributions.

8. Have you made required top-heavy minimum contributions to the SEP? Yes No

If a SEP is top-heavy or deemed top-heavy, contributions must be made for the non-key employees equal to the lesser of 3% of compensation or a percentage equal to the highest contribution rate of any key employee.

9. Have you deposited employer contributions timely? Yes No

Employers have until the due date, including extensions, of their tax return to deposit employer contributions in order to obtain a deduction.

10. If the model Form 5305-SEP was used to set up the plan, is this SEP your business's only employee retirement plan? Yes No

A sponsor of a SEP established using model Form 5305-SEP cannot sponsor another retirement plan, such as a 401(k) plan.

If you answered "No" to any of the above questions, you may have a mistake in the operation of your SEP. Many mistakes can be corrected easily, without penalty and without notifying the IRS.

■ contact your benefits professional

■ visit the IRS at www.irs.gov/ep

■ call the IRS at (877) 829-5500



SEP

A Simplified Employee Pension (SEP) is a written arrangement that allows you to make contributions toward your employees' retirement using IRAs, without becoming involved in a more complex retirement plan. Any business may establish a SEP, including a sole proprietorship.

Credit for startup costs: You may be able to claim a tax credit for part of the ordinary and necessary costs of starting a SEP. (See [Form 8881](#), *Credit for Small Employer Pension Plan Startup Costs*).

Deadline for setting up a SEP plan: You can set up a SEP by the due date (including extensions) of your business's tax return for the year.

Setting up a SEP: A SEP must be a written arrangement. The writing must include: the name of the employer, the requirements for employee participation, the signature of a responsible official, and a definite allocation formula. A SEP can be established using a model form, a prototype document or an individually designed SEP document.

You can use [Form 5305-SEP](#), *Simplified Employee Pension - Individual Retirement Accounts Contribution Agreement*, to set up a SEP. The form is an IRS model SEP document. The model form may **not** be used by an employer who:

- Maintains any other qualified retirement plan (except another SEP),
- Uses the services of leased employees,
- Wants a plan year other than the calendar year, or
- Wants an integrated SEP.

The model SEP is considered to be adopted when IRAs have been established for all eligible employees, all blanks on the form (without modification) have been completed, and specified information has been given to all eligible employees. Keep the original form. Do not file it with the IRS.

Additionally, a SEP may be established through the adoption of a prototype SEP document (usually through a mutual fund, insurance company, bank or other qualified financial institution) or an individually designed plan.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) changed many of the Internal Revenue Code's requirements and limits for qualified plans and IRAs. In order to maintain tax-advantaged status and benefit under these new provisions, SEP prototype and individually designed plans must be amended for current law. In order for employers with model SEPs to maintain tax-advantaged status and to avail themselves of new law changes they must adopt the current version of the model Form 5305-SEP. The current model [Form 5305-SEP](#) has a revision date of March 2002.

The administrator of an amended SARSEP must furnish each participant – within 30 days of the amendment – a copy of the amendment and an explanation of its effects.

Setting up SEP-IRAs: SEP-IRAs are the individual retirement accounts or annuities into which the SEP contributions are deposited. A SEP-IRA must be set up for each eligible employee. A SEP-IRA cannot be a Roth IRA or a SIMPLE IRA. Employer contributions to a SEP-IRA will not affect the amount an individual can contribute to a Roth IRA or traditional IRA, but may affect the deductibility of traditional IRA contributions.

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1. Eligible Employees

All eligible employees must be allowed to participate, including part-time employees, seasonal employees and employees who die or terminate employment during the year. An eligible employee is an employee who:

- Is at least 21 years of age.
- Has performed service for you in at least 3 of the immediately preceding 5 years.

The term "employee" includes a self-employed individual who has earned income and a working business owner.

Certain leased employees must be treated as “employees.”

Your SEP document can provide for less restrictive eligibility requirements (but not more restrictive ones). “Service” means any work performed for you for any period of time, however short. A SEP may not impose an hours- of-service requirement.

Excludable employees: The following employees do not need to be covered under a SEP:

- Employees covered by a union agreement whose retirement benefits were bargained for in good faith by you and their union.
- Nonresident alien employees who did not earn U.S. source income from you.
- Employees who received less than \$450 in compensation during the year. This amount is subject to [cost-of-living adjustments](#) after 2004.

Example 1: Employer X maintains a calendar year SEP. Under the SEP, an employee must perform service in at least 3 of the immediately preceding 5 years, reach age 21, and earn the minimum amount of compensation during the current year. Employee A worked for Employer X during his summer breaks from school in 2001, 2002, and 2003 but never more than 34 days in any year. In July 2004, Employee A turns 21. In August 2004, Employee A begins working for Employer X on a full-time basis. Employee A is an eligible employee in 2004 because he has met the minimum age requirement, has worked for Employer X in 3 of the 5 preceding years, and has met the minimum compensation requirement for 2004.

Example 2: Employer Y designs its SEP to provide for immediate participation regardless of age, service or compensation. Employee B is age 18, and begins working part-time for Employer Y in 2004. Employee B is an eligible employee for 2004.

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2. Only Business

Including Employees of Related Employers: “Employees” for purposes of determining who is an eligible employee under your SEP includes all employees of all related employers. Related employers include controlled groups of corporations that include your business, trades or businesses under common control with your business, and affiliated service groups that include your business. This means, for example, that if you and/or your family members own a controlling interest in another business, employees of that other business are “employees” for purposes of determining who is eligible to participate in a SEP.

Example. Individual P owns Business A, a computer rental agency that has 40 eligible employees. Individual P also owns Business B, which repairs computers and has 30 eligible employees. Individual P is the sole owner of both businesses. For purposes of the SEP rules, all 70 employees are treated as employed by a single employer.

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3. Notification Requirements

You must give an employee the following information within a reasonable time after the later of the date the SEP is adopted and the date the employee becomes employed:

- 1) Notice that the SEP has been adopted,
- 2) Requirements an employee must meet to receive an contribution, and
- 3) The basis upon which the employer’s contributions will be allocated.

This notification requirement can be satisfied by providing your employees with a copy of the SEP agreement (Form 5305-SEP), its instructions and the other information listed in the Form 5305-SEP instructions, if a model SEP has been adopted. If you use a prototype or individually designed SEP, similar information must be provided.

Failure to furnish the above information within a reasonable time subjects you to a \$50 penalty per failure, unless the failure is due to reasonable cause.

In addition, each year, you must furnish an annual statement to each employee participating in the SEP that shows the amount contributed to their SEP-IRA for that year. This annual reporting must be provided to the employee no later than the January 31 following the calendar year for which the report relates.

Note: Often [Form 5498, IRA Contribution Information](#), is used for this purpose.

Failure to furnish an annual statement showing the amount contributed subjects you to a \$50 penalty per failure, unless the failure is due to reasonable cause.

General Reporting Requirements:

In addition to the employee notice requirements above, the bank, insurance company or other trustee or issuer of the SEP-IRAs must comply with the following general reporting requirements:

- 1) [Form 5498](#) must be submitted to the IRS by the trustee or issuer of a SEP-IRA to report contributions to the SEP-IRA. A separate Form 5498 must be submitted for each SEP participant. This form or other statement of fair market value and account activity must also be given to participants.
- 2) [Form 1099-R](#), *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* is used to report distributions from a SEP-IRA. Distributions from a SEP-IRA are subject to the same withholding rules that apply to distributions from traditional IRAs. See [Publication 590](#), *Individual Retirement Arrangements (IRA)s*, for details on IRA distribution rules.
- 3) The [Form 5500](#), *Annual Return/Report of Employee Benefit Plan*, that is required to be filed by most qualified retirement plans is generally not required for SEPs. SEPs are exempt from the Department of Labor's reporting and disclosure requirements provided the employer satisfies certain employee notice requirements and does not impose investment restrictions on monies contributed to employees' SEP-IRAs.

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4. Compensation

An appropriate definition of compensation must be used to determine the amount of contributions. This compensation cannot exceed \$200,000 in 2003 (\$205,000 in 2004, and subject to [cost-of-living adjustments](#) for later years). The definition of compensation stated in the document must be consistently followed in the operation of the plan. Compensation generally includes the pay a participant received from you for personal services for a year including:

- 1) Wages and salaries.
- 2) Fees for professional services.
- 3) Other amounts received (cash or non-cash) for personal services actually rendered by an employee, including, but not limited to, the following items.
 - a) Commissions and tips.
 - b) Fringe benefits.
 - c) Bonuses.

If you are a self-employed individual, compensation means your earned income, or net earnings from self-employment from a business in which your services materially helped to produce the income.

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5. Traditional IRA

All SEP contributions must go to traditional IRAs set up for the eligible employees. A SEP-IRA cannot be a Roth IRA or a SIMPLE IRA.

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6. Contribution Limits

All contributions made under a SEP are employer contributions. An employee cannot defer a portion of his or her salary and contribute it to a SEP-IRA. SEP contributions must be made under a written allocation formula. A SEP may provide that contributions are a fixed percentage of employees' compensation, a fixed dollar amount for each participant, or that total contributions are to be determined each year by the employer (a discretionary contribution that is allocated pursuant to a fixed formula in the plan). An employer may vary the formula or percentage from year to year, provided the SEP is timely amended. When you contribute, you must contribute to the SEP-IRAs of all eligible employees who actually performed personal services during the year for which the contributions are made, even eligible employees who work part time, or die or terminate employment before the contributions are made. For this purpose, a business owner who is an eligible employee is treated as any other eligible employee: a business owner cannot opt out of receiving a contribution and cannot vary the contribution percentage among owners.

Contributions made to each employee's SEP-IRA cannot exceed the lesser of \$40,000 for 2003 (\$41,000 for 2004, subject to [cost-of-living adjustments](#)) or 25% of the eligible employee's compensation. The amount of compensation taken into account is limited to \$200,000 in 2003 (\$205,000 in 2004 and is subject to [cost-of-living adjustments](#) for later years). If your SEP plan document specifies lower contribution limits, then the lower limits control. All your defined contribution plans must be aggregated for purposes of these limits.

There are special rules if you are a self-employed individual. When figuring the deduction for contributions made to your own SEP-IRA, compensation is your net earnings from self-employment, which takes into account both the following deductions: the deduction for one-half of your self-employment tax and the deduction for contributions to your own SEP-IRA. For this reason, you determine the deduction for contributions to your own SEP-IRA indirectly by reducing the contribution rate called for in your plan. For more information on the deduction limitations for self-employed individuals, see [Publication 560](#), *Retirement Plans for Small Business*.

Employer contributions to a SEP-IRA will not affect the amount an individual can contribute to a Roth IRA or a traditional IRA. However, it may preclude an individual from receiving a tax deduction for contributions to a traditional IRA. See [Publication 590](#) for details.

Tax Treatment of Contributions

You can deduct your contributions and your employees can exclude these contributions from their gross income. SEP contributions are not subject to federal income tax withholding, social security, Medicare, and federal unemployment (FUTA) taxes.

Reporting on Form W-2: Do not include SEP contributions on employees' Form W-2, but check the "Retirement plan" box in box 13. For more information, see the Form W-2 instructions.

When to Deduct Contributions

If your SEP is maintained on a calendar-year basis, contributions to the SEP are deductible in the tax year containing the end of the calendar year for which the contributions were made. If you file your tax return and maintain the SEP using a fiscal year or short tax year, you deduct contributions made for a year on your tax return for that year. To be deductible for a tax year, the contributions must be made by the due date, plus extensions, of the tax return for that year.

Example 1. Your tax year is the fiscal year ending June 30 and your SEP uses a calendar year. You deduct SEP contributions made for the calendar year 2003 (including contributions made in 2003 before July 1, 2003) on your tax return for your tax year ending June 30, 2004.

Example 2. You are a sole proprietor whose tax year is the calendar year. You deduct SEP contributions for the calendar year 2003 (including contributions made in 2004 by April 15, 2004) on your tax return for the tax year ending December 31, 2003.

Where to Deduct Contributions

Deduct the contributions you make for your common-law employees on your tax return. For example, sole proprietors may deduct them on Schedule C (Form 1040), *Profit or Loss From Business*, or Schedule F (Form 1040), *Profit or Loss From Farming*, partnerships deduct them on Form 1065, *U.S. Return of Partnership Income*, and corporations may deduct them on Form 1120, *U.S. Corporation Income Tax Return*, Form 1120-A, *U.S. Corporation Short-Form Income Tax Return*, or Form 1120S, *U.S. Income Tax Return for an S Corporation*.

Sole proprietors and partners may deduct contributions for themselves on line 30 of the 2003 Form 1040, *U.S. Individual Income Tax Return*. (If you are a partner, contributions for yourself are shown on the Schedule K-1 (Form 1065), *Partner's Share of Income, Credits, Deductions, etc.*, you get from the partnership.)

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7. Vesting

Once you make a SEP contribution to an employee's SEP-IRA, it is owned by the employee and cannot be made subject to a vesting schedule or taken back by you.

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8. Top-Heavy Minimum

If your SEP is "integrated with social security" (model SEPs do not have this feature), a minimum contribution must be made for non-key employees when the SEP is top-heavy. Generally, a SEP is top-heavy when more than 60% of aggregate employer contributions have gone to key employees. Many SEP plans are drafted to operate as if they were always top-heavy ("deemed top-heavy"). A key employee is any employee who, at any time during the preceding year was:

- An officer of the employer with compensation greater than \$130,000 (subject to [cost-of-living adjustments](#)),
- A 5% owner of the employer, as defined in section 416(i)(1)(B)(i) of the Internal Revenue Code, or
- A 1% owner of the employer with compensation greater than \$150,000.

If a SEP is top-heavy or deemed top-heavy, contributions must be made for all non-key employees equal to the lesser of 3% of compensation or a percentage equal to the highest contribution rate of any key employee.

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9. Depositing Employer Contributions

If your SEP is maintained on a calendar-year basis, in order to obtain a deduction for employer contributions, such employer contributions must be made to the financial institution maintaining the employees' SEP-IRAs no later than the due date for filing the employer's tax return (including extensions) for the employer's tax year with or within which the calendar year for which the contribution is made ends. If the SEP is maintained on the employer's taxable year that is a fiscal year, contributions must be made by the due date (including extensions) for filing the tax return for that year.

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10. Only Retirement Plan

If you use model Form 5305-SEP to set up your SEP, it must be the only retirement plan other than another SEP you maintain.

You may maintain a qualified plan if the SEP is established using a prototype or individually designed plan.

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